

California State University:

**Evaluation of a Contractor Dispute
at the Fullerton Campus**

February 1997
96113

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February 25, 1997

96113

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

Summary

The Bureau of State Audits conducted an audit to determine whether California State University (CSU) had an obligation to intervene in the dispute between a construction prime contractor, Amelco Electric (Amelco), and a subcontractor, Computer Consulting Operations Specialists, Inc. (CC-OPS). CSU had entered into a contract with Amelco, wherein Amelco agreed to provide labor and materials to upgrade the electrical and telecommunications infrastructure at CSU's Fullerton campus.

Although CSU did not have a legal obligation to intervene in the dispute, to ensure that the project was completed, CSU met with Amelco and CC-OPS to mediate the dispute. Additionally, in an attempt to relieve the parties of contentious issues, CSU waived liquidated damages against the prime contractor for failing to complete the contract on time and extended the contract deadline by 185 days. Liquidated damages is the amount of money specified in a contract to be awarded in the event the agreement is violated. For example, the contract between CSU and Amelco specified that Amelco would pay CSU \$1,500 for each day that the project was unfinished beyond the contract completion date.

Despite its attempt to mediate, CSU has acknowledged that it may be partially responsible for some of the delays which necessitated the extension of the original contract completion date. Another issue that contributed to the dispute is that CSU did not originally enforce a contract clause which required Amelco to have a supervisor on site at all times while any work

was being performed. CSU did not begin to enforce this provision until problems developed on the work site at night. Amelco attributes the problems to CC-OPS, and is therefore demanding reimbursement from the subcontractor for the added cost of the nighttime supervisor. However, if CSU had consistently enforced this contract clause, it is less likely that this would have been an item of contention in the dispute.

As of February 24, 1997, the dispute between Amelco and CC-OPS is the subject of a lawsuit in the Orange County Superior Court.

Background

On August 2, 1994, CSU entered into a \$9.6 million contract with Amelco. Amelco agreed to provide labor and materials for a project to upgrade the electrical and telecommunications infrastructure at CSU's Fullerton campus. The amount of the contract subsequently increased by approximately \$409,000 due to a series of contract change orders. On August 26, 1994, Amelco entered into a subcontract with Computer Cabling Contractors Corporation (CCCC), in the amount of \$3 million, wherein CCCC agreed to perform certain parts of the telecommunications work. However, because CCCC was unable to obtain a bond, on January 23, 1995, MiraCom, Inc. (MiraCom) was substituted for CCCC by Amelco. The subcontract with MiraCom, in the amount of \$729,000, was for labor only; materials were to be provided by Amelco. On June 7, 1995, CC-OPS purchased MiraCom. Two months later, on August 4, 1995, Amelco entered into a subcontract with CC-OPS, in the amount of \$629,000, for the work remaining in the MiraCom subcontract.

The Trustees of CSU, under the powers granted by the Legislature, have direct and sole responsibility for all CSU capital improvement projects. Therefore, the Trustees are the contracting party for all of these types of projects. The Division of Physical Planning and Development (PP&D), within the Office of the Chancellor, administers construction contracts awarded by the Trustees. PP&D acts on the authority of the Trustees and is responsible for the construction of all CSU campuses, as well as any other buildings, facilities, or improvements within the CSU system. PP&D is organized into the following four functional areas: Architecture/Engineering, Construction Management, Policy and Planning, and Program Management.

Construction Management is responsible for all phases of administering and managing construction contracts. For example, Construction Management controls the advertisement, receipt, and review of bids; the award of contracts; contract acceptance; claims negotiation and settlement; and construction administration. Construction Management also ensures that all deficiencies noted during inspection are corrected. Additionally, Construction Management contracts with on-site project managers and construction inspectors who assist CSU in overseeing projects.

Because Construction Management was responsible for administering and managing the construction contract with Amelco, CSU Fullerton's role was limited to outlining the scope of the project, attending project meetings, and facilitating the needs of the prime contractor and subcontractors.

Scope and Methodology

The Joint Legislative Audit Committee requested that the Bureau of State Audits perform an audit of the dispute between Amelco and CC-OPS. Additionally, the audit examined PP&D's role.

Our purpose was to ascertain CSU's role in the dispute; to determine whether CSU had an obligation to intervene in the dispute; and to obtain an understanding of any other significant issues related to the dispute.

To obtain an understanding of the significant issues related to the dispute, we interviewed employees from the Construction Management unit of PP&D. Additionally, we interviewed the on-site project manager and the construction inspector, who were under contract to CSU to oversee the project. We also interviewed CSU internal auditors who had performed an audit of the subcontract, as well as the dispute between Amelco and CC-OPS. Furthermore, we reviewed supporting documentation obtained from the internal auditors and correspondence from both Amelco and CC-OPS. We also reviewed the legal file related to the lawsuit between Amelco and CC-OPS, which we obtained from the Orange County Superior Court.

To determine whether CSU had an obligation to intervene in this dispute, we reviewed the opinion of the Chief Counsel of the Department of General Services' Office of Legal Services, and we reviewed the contract itself to determine whether CSU was contractually obligated to intervene in disputes between the prime contractor and a subcontractor. Additionally, we asked our legal counsel to review this matter. Our attorney reviewed

the opinion of the Chief Counsel of the Department of General Services' Office of Legal Services and portions of the contract between CSU and Amelco, as well as relevant statutory and case law.

The Dispute Between Amelco and CC-OPS

Approximately seven months into the subcontract, CC-OPS discontinued work because Amelco had stopped paying it. According to the final stop notice that CC-OPS submitted to CSU on May 1, 1996, the subcontractor received two payments totaling approximately \$98,000. Since Amelco and CC-OPS were unable to reach an agreement to bring CC-OPS back to work, Amelco completed the remaining work itself.

Amelco contends that it withheld payments because of delays in the project's completion that it alleges CC-OPS caused. Therefore, Amelco withheld amounts from CC-OPS to cover potential liquidated damages and additional expenses incurred managing CC-OPS' work past the project completion date. Amelco also withheld payments to reimburse itself for the expense of a nighttime supervisor it had to provide to oversee CC-OPS' work. Furthermore, Amelco withheld payments because it completed the work originally scheduled for CC-OPS.

On the other hand, CC-OPS claims that it was not responsible for delays in the project. CC-OPS alleges that these delays resulted because Amelco did not have the work site ready on time for CC-OPS' labor crews; Amelco did not provide materials to the labor crews promptly; and, at various times, CSU Fullerton denied the labor crews access to construction areas.

Because Amelco had not paid CC-OPS for all of its subcontract work, on February 22, 1996, CC-OPS submitted a stop notice to CSU against Amelco in the amount of \$319,774. A stop notice is a legal protection available to all subcontractors that are not paid for services rendered. California Civil Code, Section 3103, governs the protections that a stop notice provides subcontractors. Under these provisions, CSU must withhold payment from Amelco for the amount specified in the stop notice.

CSU, as is its practice in all construction contracts, retains 5 percent of the progress payments due to the prime contractor until the project is completed. In the event that CSU receives a stop notice, it simply applies it against this 5 percent. In this contract, CSU had retained approximately \$500,000, which was 5 percent of the total amount owed of \$10 million. Had

the stop notice exceeded the 5 percent, CSU would have withheld the remaining amount from the monthly progress payments to the prime contractor.

On February 26, 1996, CSU honored the stop notice CC-OPS submitted. The general conditions of the contract specify that CSU will retain up to 125 percent of the stop notice amount to cover any present or future subcontractor claims. CC-OPS amended its initial stop notice three times to reflect changes in the amount it alleged Amelco owed. On March 18, 1996, CC-OPS submitted its third stop notice to CSU for \$319,774, the same amount as the original stop notice. As a result, CSU placed a hold on \$399,717, or 125 percent of the stop notice amount, against the amounts that CSU had retained from Amelco.

On April 18, 1996, Amelco submitted a bond to CSU for the release of the stop notice. This procedure is referred to as "bonding around" a stop notice. A contractor has a legal right to bond around a stop notice if it disagrees with the correctness or validity of a subcontractor's stop notice. California Civil Code, Section 3196, specifies that if a contractor disputes the correctness, validity or enforceability of any stop notice a subcontractor submits, the public entity may permit the original contractor to file a bond, executed by an insurance company, in an amount equal to 125 percent of the claim stated in the stop notice. Consequently, Amelco purchased a bond from the United Pacific Insurance Company for \$399,717 for the release of CC-OPS' stop notice. The bond ensures that if CC-OPS prevails in the lawsuit, Amelco or the insurer will pay the amount specified by the court, up to the amount of the bond. Upon the filing of such a bond, the public entity, in this case CSU, shall not withhold any money from the original contractor to cover the stop notice.

On April 22, 1996, CSU honored Amelco's bond and released the \$399,717 hold that CSU had placed against the 5 percent retention. However, on May 1, 1996, CC-OPS submitted a final stop notice to increase the previous stop notice from \$319,774 to \$352,473. CSU could only honor the \$32,699 difference between the two notices because Amelco had bonded around the previous notice. Therefore, CSU placed a hold of \$40,874 against the 5 percent retention, 125 percent of the difference between the two stop notices. On May 8, 1996, Amelco amended its original bond, increasing it to \$440,591 to release the final stop notice submitted by CC-OPS. On May 15, 1996, CSU accepted Amelco's increased bond and released the remaining hold on the 5 percent retention.

Currently, CSU is still holding Amelco's bond and the dispute between Amelco and CC-OPS is the subject of a lawsuit in the Orange County Superior Court. If CC-OPS prevails in the lawsuit, Amelco will be required to pay a court-specified amount. The bond Amelco purchased insures that if Amelco does not pay CC-OPS, then the insurer will pay up to the amount of the bond, thereby relieving CSU of any financial responsibility.

CSU's Role in the Dispute

CSU has asserted it was not obligated to intervene in the dispute between Amelco and CC-OPS, a position the Chief Counsel of the Department of General Services' Office of Legal Services agrees with. Furthermore, when we reviewed the contract, we noted that it specified CSU would not arbitrate disputes between the contractor and its subcontractors.

Our legal counsel, after reviewing the opinion of the Chief Counsel of the Department of General Services' Office of Legal Services, portions of the contract between CSU and Amelco, and relevant statutory and case law, also concluded that CSU did not have a legal obligation to intervene. However, CSU still had an interest to attempt to resolve the dispute and to mitigate any delays or damages. Besides attempting to persuade the parties to resolve their dispute, CSU did not have any legal remedy to force an end to the dispute.

Nevertheless, CSU did attempt to resolve the dispute. On March 11, 1996, CSU held a meeting with Amelco and CC-OPS in an attempt to mediate the dispute. Additionally, CSU waived liquidated damages against Amelco for failure to complete the contract on time and extended the contract deadline by 185 days. And, while Amelco reimbursed CSU for expenses incurred as a result of project delays, those expenses only totaled approximately \$32,000, substantially less than liquidated damages would have been at a rate of approximately \$1,500 per day. Therefore, although CSU did not have a legal obligation to intervene in the dispute, it did attempt to eliminate one of the major issues by extending the contract deadline 185 days and forgoing liquidated damages.

Although CSU attempted to resolve the dispute, it has acknowledged that it may be partially responsible for some of the delays which necessitated the extension of the original contract completion date. Another issue that contributed to the dispute is that CSU did not originally enforce a contract clause that specified that Amelco had to have a supervisor on site at any time work was performed. CSU did not begin to enforce

this clause until problems developed on the work site at night. We discussed this with CSU's construction manager and on-site project manager. They stated that Amelco attributes the problems to CC-OPS and demands CC-OPS cover the added cost of the nighttime supervisor. However, we reviewed the general conditions of the contract, noting that Amelco was required to have a supervisor on site at all times while any work was being performed. If CSU had consistently enforced this clause, it is less likely that this would have been an item of contention in the dispute.

Additionally, Amelco and CC-OPS both allege that at various times CSU denied them prompt access to construction areas, thereby causing delays. We reviewed a letter dated February 2, 1996, from Amelco to CSU, in which Amelco indicates CSU directed work be stopped in certain buildings. As a result, Amelco claims that the project completion date was delayed two weeks. Additionally, we reviewed a letter dated February 29, 1996, from CC-OPS to Amelco and the CSU on-site project manager, in which CC-OPS indicated that some work was delayed a total of 23 days because CSU denied CC-OPS access to construction areas.

We interviewed the CSU on-site project manager and the construction inspector regarding these allegations. They both stated the allegations were false: CSU had not stopped work in any of the buildings nor denied either Amelco or CC-OPS access. Furthermore, the construction inspector stated that CSU had actually exceeded its contractual obligation to facilitate access. For example, the contract specifies Amelco was limited to working on the horizontal wiring of only two buildings at a time; however, to facilitate the timely completion of the project, CSU allowed Amelco to work on three buildings at a time. Notwithstanding, CSU contends that it addressed the allegations of Amelco and CC-OPS by granting a 185-day contract extension. In exchange for the extension, Amelco agreed that it would hold CSU harmless for any delays that may have necessitated the extension.

Conclusion

CSU did not have a legal obligation to intervene in the dispute between Amelco and CC-OPS. However, to ensure that the project was completed, CSU did attempt to resolve the dispute. CSU met with both parties to mediate the dispute. Additionally, to relieve the parties of contentious issues, CSU waived

liquidated damages against the prime contractor for failing to complete the contract on time and extended the contract deadline by 185 days.

Although CSU attempted to resolve this dispute, it has acknowledged that it may be partially responsible for some of the delays that necessitated the extension of the original contract completion date. Another issue that contributed to the dispute is that CSU did not originally enforce a contract clause that specified that Amelco had to have a supervisor on site at all times while any work was being performed. CSU did not begin to enforce this clause until problems developed on the work site at night. Amelco attributes these problems to CC-OPS and asserts that CC-OPS should reimburse it for the added cost of the nighttime supervisor. If CSU had consistently enforced this contract clause, it is less likely that this would have been an item of contention in the dispute.

Additionally, Amelco and CC-OPS both allege that CSU denied them prompt access to construction areas at various times, thereby causing project delays. According to the CSU on-site project manager and the construction inspector, these allegations are false. Furthermore, according to the construction inspector, CSU actually exceeded its contractual obligation to facilitate access to buildings. Notwithstanding, CSU contends that it addressed the allegations of Amelco and CC-OPS by granting a 185-day extension to the contract completion date.

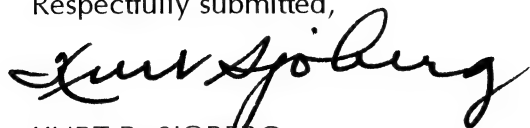
As of February 24, 1997, the dispute between Amelco and CC-OPS is the subject of a lawsuit in the Orange County Superior Court.

Recommendation

CSU should enforce all of the terms of future contracts, even those that it deems less substantial.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Kurt Sjoberg". The signature is fluid and cursive, with the first name "Kurt" and last name "Sjoberg" clearly distinguishable.

KURT R. SJOBERG
State Auditor

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BARRY MUNITZ
Chancellor

February 14, 1997

Mr. Kurt R. Sjoberg
State Auditor
Bureau of State Audits
660 "J" Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

We have reviewed a preliminary draft of the report entitled "California State University: Evaluation of a Contractor Dispute at the Fullerton Campus." We are pleased that the review conducted by your office confirms that the California State University administered the contract in compliance with the various state statutes governing public work construction.

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Attached is our response to the report recommendation. Mr. Larry Mandel, University Auditor, will be available to provide further clarification or comments regarding our response.

Sincerely,

Barry Munitz
Chancellor

Attachment

cc: Molly Corbett Broad
Larry Mandel

CSU Response to California State Auditor
Report Number 96113, entitled:
" California State University: Evaluation of a Contractor Dispute at the Fullerton Campus"

Recommendation

CSU should enforce all of the terms of future contracts, even those that it deems less substantial.

Response

The California State University concurs with the recommendation and will make every effort to enforce all of the terms of future contracts.

Comments

California State Auditor's Comments on the Response From the California State University

To provide clarity and perspective, we are commenting on the California State University's response to our audit report. The number corresponds to the number we have placed in the response.

- ① The CSU response indicates that we reviewed CSU's compliance with various state statutes governing public works construction. This overstates the scope of our audit. Our audit had a more narrow focus, which was to determine whether CSU had an obligation to intervene in the dispute between Amelco Electric and Computer Consulting Operations Specialists, Inc.

cc: Members of the Legislature
 Office of the Lieutenant Governor
 Attorney General
 State Controller
 Legislative Analyst
 Assembly Office of Research
 Senate Office of Research
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